

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 05 AMMAN 001214

SIPDIS

TREASURY FOR OASIA -- MARSHALL MILLS, WON CHANG
USDOC 4520/ITA/MAC/ONE/COBERG

E.O. 12958: DECL: 02/25/2008

TAGS: [EFIN](#) [EAID](#) [PGOV](#) [JO](#)

SUBJECT: LOTS OF HOLES TO BE FILLED IN JORDAN'S 2003 BUDGET

REF: AMMAN 485

Classified By: Amb. Edward W. Gnehm. Reasons 1.5 (b) and (d)

11. (c) Summary. Jordan's new 2003 budget signals a very difficult fiscal year ahead for Jordan: Filling the holes needed to meet a 4.3% of GDP deficit target includes finding \$100 million in additional spending cuts and \$100 million in still unidentified foreign grants, as well as compensating for probable revenue shortfalls. In the current political environment, this challenge is likely to test Jordan's commitment to fiscal discipline and sound economic policy as never before. U.S. support for sound economic policies and reform of government finances, including through the provision of supplemental assistance connected to a military conflict, will be critical. End Summary.

12. (sbu) Finance Minister Michel Marto announced on February 5 a JD2.44 billion (\$3.45 billion, JD1=\$1.41) "emergency budget" for the year 2003. The announcement was more than two months behind Jordan's normal budget calendar, delayed by the difficulty the GOJ faced in compressing expenditure growth and finding new sources of income given weakness in revenue growth. The budget will likely meet the deficit targets agreed with the IMF in the May 2002 stand-by program (an IMF team is currently in town). That Marto was able to announce a budget that meets the IMF targets despite the intense pressures currently on Jordan is a demonstration of the government's ongoing commitment to sound economic policy.

13. (sbu) The main features of the budget, which are also summarized in the table at the end of this report, are as follows.

Deficit Increase, but Consistent with IMF

14. (sbu) An increase in the overall deficit to JD316 million from JD259 million in 2002. As a share of GDP, this represents an increase to 4.3% from 3.8%. An increase is, however, consistent with the targets set in the IMF program (allowing for differences in Jordanian and IMF accounting). After taking into account rescheduling of JD100 million of debt service by Paris Club and other creditors, the government will need to borrow an additional net JD216 million, compared to JD184 million last year. The government expects to raise the bulk of this by issuing government securities in domestic markets. The GOJ will also welcome new concessional foreign debt (e.g. PL 480 food loans) that helps finance budgetary expenditure.

Expenditures Up, but Only a Bit

15. (sbu) Total expenditure increases by JD157 million to JD2,441 million from JD2,289 million in 2002. However, the total will fall as a share of GDP from 34 percent to 33 percent according to Finance Ministry projections. This means another year of increasingly painful austerity for GOJ ministries and agencies. Of total spending, approximately JD2,009 million, or 82%, is current expenditure over which the government has little discretion (salaries, pensions, supplies, and interest). As was the case last year, the military and security budgets receive the bulk of the increase in discretionary spending, including a JD54 million increase in military and security service salaries ordered by King Abdullah during 2002. The education and health ministries also receive significant increases (see Table II below). The remaining JD502 million is planned for capital spending on roads, water projects, schools, courthouses, and other government buildings. As was also the case last year, the total includes JD70 million (1% of GDP) in still-to-be-identified cuts in ministries' budgets.

Revenues Stagnate

16. (sbu) Anticipated domestic revenue from tax and non-tax sources represents 25% of GDP in 2003, or JD1,803 million.

This is up from JD1,752 million in 2002, but unchanged as a share of GDP. Tax revenues are slated to rise by 7.2% after stagnating in 2002 due to a fall off in customs and General Sales Tax (GST) revenues. In 2003, non-tax revenues increase by JD11 million to JD690 million. Tax increases will also have to compensate for an expected decrease in the government's so-called "oil surplus" (the difference between what the GOJ pays Iraq and what it receives from selling the oil to the refinery company) due to higher global energy prices.

17. (c) Marto's public presentation did not provide detail on how an increase in tax receipts would be accomplished. In a private meeting, he told the Ambassador confidentially that the measures agreed within the government are 1) an increase in the basic GST rate from 13% to 15% and in the lower GST rate from 2% to 5% that would raise JD30 million in new revenue, 2) an increase in retail prices for petroleum products that would raise JD40-50 million (although prices for some products would remain below OECD averages), 3) imposing a 5% tax on interest income, and 4) initiating a 2% income withholding tax on imported goods that will improve efficiency of income tax collection. Marto said the government had agreed, with the King's blessing, to phase in these measures between March and July 2003. All of them generated hot debate within the government, but Marto said the principle of increasing taxation of upper and middle income groups and minimizing the impact of new measures on the poor had been accepted, despite, he said, the strong influence of the business community on the King's economic thinking.

Foreign Grants Budgeted for, but not Identified

18. (sbu) The final major budget element is foreign grants, for which the budget stipulates an increase to JD322 million from JD278 million received in 2002. This amount includes approximately JD70 million (\$100 million) in still-to-be-identified foreign grants. Marto told the Ambassador that a portion of the identified grants -- approximately JD57 million -- will be used to finance Social and Economic Transformation Plan (SETP) spending also included on the expenditure side of the budget. This will be supplemented by JD55 million in SETP grants received in 2002 but not yet spent, bringing total basic 2003 SETP spending to JD112 million. Any additional SETP spending would be financed by additional grants received above the JD322 million.

OBSERVATIONS

19. (C) Following are embassy observations about the budget, informed by our conversations with Marto, his deputy Dr. Mohammed Abu Hammour, and members of the visiting IMF mission.

-- Despite the "emergency" label, this is not a war budget. It does not take into account expected revenue losses (including of the oil surplus) and expenditure increases consequent to a military conflict with Iraq. Rather, the moniker sends the signal that 2003 will be a very difficult year with or without a war. If there is a war, Marto will count on extraordinary U.S. assistance to make up for budget shortfalls, as he discussed in late 2002 in Washington.

-- The budget's achievability depends on the observer's confidence in the government's ability to impose additional spending cuts (at least the JD70 million figured into the deficit) and revenue measures over the course of the year, as well as to raise \$100 million in so far unidentified foreign grants. Past performance gives a measure of confidence (see reftel for the heroic measures taken to bring the 2002 deficit within striking distance of the IMF target). As in the past, capital spending on sorely needed improvements in infrastructure will likely bear the brunt of cuts.

-- However, given the current political tension surrounding a conflict with Iraq and the slowness of progress on the Palestinian issue -- plus the years of fiscal restraint the country has already endured -- the political difficulty of tough decisions (which may be equivalent to at least 2-3% of GDP) is likely much more intense than in past years. Parliamentary elections by summer will bring increased pressures from political leaders for fiscal generosity, and a new Parliament by mid-year will most likely make austerity even harder to bear.

-- The budget does not make bold structural changes: it's business as usual on both the revenue and expenditure sides. On revenues, the tax system is clearly not responsive to GDP growth. In 2002, the GST, which accounts for 60 % of non-tax revenue, stagnated, as it failed to capture income growth that was not reflected in greater consumption (see Table IV).

Greater utilization of direct income taxation to supplement the GST (which the minister prefers as being relatively easy and inexpensive to administer) could provide greater stability and diversification in the tax system, and also help make the tax structure more progressive. On expenditures, some progress has been made in overhauling the over-generous military pension system (the length of service requirement has been extended), but more needs to be done to make this system less generous and thereby decrease its disincentives to employment and productive use of resources.

-- Recurring expenditures under SETP projects are not yet a budgetary issue, but are likely to be in the future. So far, only a relatively small amount has been spent on SETP projects (about JD40-50 million in 2002). But an increase in recurring expenditures in future years underscores the need for a more fundamental approach to revenue and expenditure reform.

-- The budget does not include spending on critical infrastructure projects, such as the Disi water project, the Samra power plant project, the Aqaba-Amman natural gas pipeline, and the Amman city center (Abdali) project. The government hopes that these will be financed by the private sector through "build-own-operate" arrangements. The government is likely however to be under considerable pressure to provide financial guarantees for these projects, which would increase its sovereign debt levels.

Comment: A Chance to Encourage Fiscal Reform

10. (c) In the end, the budget is likely to prove a paper exercise given the overwhelming impact a military conflict would have on Jordan's finances. It serves, however, to highlight the fiscal pressures on the government as well as the need for structural changes in revenues and expenditures in order to put the government's finances on a sustainable track. Emergency assistance provided by the U.S. or other countries to help Jordan adjust to a conflict should provide opportunities to leverage such changes. Our bottom line is that the King's and government's support for the sound economic policies supported by the IMF remains intact, but that this commitment is likely to be tested in 2003 as never before.

11. (c) The budget also serves to highlight the political pressures on the finance minister. Marto confidentially and frankly described the growing fatigue with fiscal discipline he perceives on the part of the King, prime minister and other ministers. We believe the King continues to value his service, but that patience could wear thin since he hears only criticism of Marto from the vast majority of his other economic and political advisers. The alternative to Marto is a less experienced minister who would be picked for his readiness to spend and take on new debts. We can help to the extent that we find ways to counterbalance the pressures on Marto by expressing support for him and his policies.

----- TABLES -----

TABLE I
Jordan's 2003 Budget: Basic Features

| | (JD millions) | | |
|------------------------------------|----------------|------------------|----------------|
| | 2003 budget | 2002 estimate | 2001 actual |
| Revenues | 1803 | 1752 | 1719 |
| Domestic Revenue | 1764 | 1680 | 1638 |
| Tax Revenues | 1074 | 1000 | 996 |
| Non-Tax Revenues | 690 | 679 | 642 |
| Other Revenues | 39 | 73 | 81 |
| Foreign Grants | 322 | 278 | 249 |
| Current Expenditures | 1939 | 1852 | 1789 |
| Current spending (non-interest) | 1799 | 1660 | 1568 |
| Interest Payments | 210 | 192 | 220 |
| Unidentified cuts | -70 | - | - |
| Capital Spending | 502 | 437 | 404 |
| Balance | -316 | -259 | -224 |
| Rescheduled Interest | 100 | 75 | 69 |
| Borrowing need | -216 | -184 | -156 |
| Note: GDP | 7350 | 6780 | 6260 |

TABLE II
CURRENT EXPENDITURE BY MINISTRY/GOVT. DEPARTMENT

(JD millions)

| | 2003 Budget | 2002 Est. |
|--------------------------------------|----------------|--------------|
| Royal Court | 23 | 21 |
| Parliament, Prime Ministry | 10 | 8 |
| Administration, Civil Service | 1 | 1 |
| Defense and Royal Med. Services | 427 | 397 |
| Interior | 182 | 165 |
| Justice | 20 | 16 |
| Foreign Affairs/Palestinian Affairs | 21 | 20 |
| Finance * | 859 | 796 |
| Industry and Trade | 3 | 3 |
| Planning | 2 | 2 |
| Tourism and Antiquities | 2 | 2 |
| Municipal, Rural Affairs | 3 | 2 |
| Energy and Natural Resources | 3 | 3 |
| Public Works and Housing | 9 | 7 |
| Agriculture | 10 | 10 |
| Water/Jordan Valley Authority | 6 | 6 |
| Environment | 1 | 0 |
| Education | 276 | 248 |
| Health | 126 | 116 |
| Social development | 5 | 5 |
| Labor | 2 | 1 |
| Information | 3 | 2 |
| Culture | 3 | 2 |
| Transport/Civil Aviation/Meteorology | 11 | 10 |
| Post and Telecommunications | 1 | 9 |
| The Royal Geographic Center | 1 | 1 |
| TOTAL | 2009 | 1852 |

* Includes pensions, interest expense, subsidies, and transfer payments.

TABLE III
CAPITAL EXPENDITURES BY MINISTRY/GOVT. DEPARTMENT

(JD millions)

| | 2003 budget |
|------------------------------------|----------------|
| Finance * | 170 |
| Planning/National Planning Council | 101 |
| Public Works & Housing | 47 |
| Water/Jordan Valley Authority | 46 |
| Interior Ministry/Public Security | 23 |
| Health | 23 |
| Education | 12 |
| The Royal Medical services | 10 |
| Post and Telecommunications | 10 |
| Interior Ministry/Civil Defence | 9 |
| Agriculture | 9 |
| Transport/Civil Aviation Authority | 8 |
| Tourism & Antiquities | 7 |
| Social development | 5 |
| Energy/Natural resources Auth. | 3 |
| Min. of Tourism/ Antiquities Dept. | 3 |
| Foreign Affairs | 3 |
| Interior | 2 |
| Water and Irrigation | 2 |
| Other | 12 |
| TOTAL | 502 |

* Finance Ministry capital budget includes spending counterpart of foreign aid for equipment purchases (e.g. military), and loans, advances, and contributions.

TABLE IV
STRUCTURE OF REVENUES

(JD millions)

| | 2003 budget | 2002 estimate | 2001 final |
|-------------------------|----------------|------------------|---------------|
| Total Domestic Revenues | 1,803 | 1,752 | 1,719 |
| Tax Revenues | 1,074 | 1,000 | 996 |
| Income Tax | 201 | 196 | 195 |
| Customs duties | 190 | 220 | 228 |
| General Sales Tax | 604 | 511 | 503 |
| Other Local Taxes | 79 | 74 | 70 |
| Non-Tax Revenues | 690 | 679 | 642 |
| Licenses | 33 | 32 | 32 |

| | | | |
|-------------------------------------|-----|-----|-----|
| Fees | 226 | 225 | 215 |
| Receipts from Gov't institutions | 139 | 139 | 137 |
| Revenues from Gov't Services | 28 | 24 | 25 |
| Miscellaneous | 292 | 283 | 257 |
| GNEHM | | | |